



The impacts of economic importance difference of a joint venture (JV) held by partners and partners' size difference on the extraction of rivalrous and non-rivalrous private benefits in a JV



Xiaoxiang Zhang*, Jie Wen

School of Business, Management and Economics, University of Sussex, United Kingdom

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ABSTRACT

We investigate the impacts of economic importance difference of a JV held by partners and partners' size difference on the extraction of rivalrous and non-rivalrous private benefits in a JV. Focusing on 824 JV events during the period 2001–2012 in the global markets we find that, where the economic importance difference of a JV held by partners is large, a partner with a more economically important JV extracts more rivalrous type and non-rivalrous type of private benefits. Under the situation where partners' size difference is large, a smaller partner extracts more non-rivalrous type of private benefits. Whether arbitrage trading between two partners' shares outperforms the trading strategy of buy-hold two partners' shares during the JV announcement period depends on whether there are large private benefits available or not.

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1. Introduction

Given the shared governance structure, joint ventures (JVs) are not only associated with synergies and common benefits, but also with significant private benefits (Kumar, 2010, 2011). Particularly, private benefits are the main factor leading to differential wealth gains between two partners when they announce a JV (Kumar, 2011). Previous literature suggest that, depending on whether private benefits acquired by a partner damage the value to the other partner, private benefits associated with a JV can be classified into two different types (Kumar, 2010, 2011). Type 1 private benefits are those non-rivalrous type of private benefits which can be extracted by a partner without damaging value to the other partner. Type 2 private benefits are those rivalrous type of private benefits which can be extracted by a partner by damaging the value to the other partner.

In this research, we highlight that there are different benefit-cost tradeoffs in extracting different types of private benefits: a cooperative environment in a JV can enhance the scope of non-rivalrous type of private benefits while a non-cooperative environment in a JV can enhance the costs in extracting rivalrous type of private benefits. We explore how JV's economic importance difference and size difference between partners affect two types of private benefits extractions in a JV. Based on our analysis of 824 JV events, we argue that, under the situation that the economic importance difference of a JV held by partners is

large, a partner with a more economically important JV has enhanced benefits in extracting non-rivalrous type of private benefits and reduced costs in extracting rivalrous type of private benefits. In contrast, under the situation where partners' size difference is large, a smaller partner has enhanced benefits in extracting non-rivalrous type of private benefits as well as enhanced costs of extracting rivalrous type of benefits.

We contribute to the literature in several important ways. First, Kumar (2010, 2011) established the theoretical benefit-cost trade-off concept in extracting private benefits out of a JV in a general way. Our theoretical contribution is that we further develop such a benefit-cost trade-off concept by distinguishing two different trade-offs associated with (1) enhanced scope to acquire type 1 private benefits in a JV characterised by cooperative environment and (2) enhanced costs to acquire type 2 private benefits in a JV characterised by non-cooperative environment. In this we differ from Kumar (2011) who focuses on private benefits as the main reason leading to differential wealth gains between two partners when they form a JV. Our specific theoretical contribution is to develop a broader understanding of factors affecting different types of private benefits associated with the JV. We theorise that whether type 1 or type 2 private benefits are extracted by a partner out of the JV depends on the impacts on the benefit-cost tradeoffs associated with the economic importance difference of a JV held by partners as well as the partners' size difference.

Second, empirically, we shift the level of analysis of wealth gains in the JV from the individual partner to the dyadic level (Gulati & Wang, 2003; Kumar, 2007, 2008, 2011) in order to reveal the two types of private benefits extracted out of a JV. We document two different types of private benefits extracted out of a JV using a large sample of 824 JVs,

* Corresponding author at: School of Business, Management, and Economics, Sussex University, Falmer, Brighton BN1 9SL, United Kingdom.

E-mail address: xiaoxiang.zhang@sussex.ac.uk (X. Zhang).

recorded in the global markets from 2001 to 2012 and find that Type 2 private benefits are more prevalent than Type 1 private benefits, extending Kumar (2011).

Third, given the co-existence of JV's common benefits and private benefits, we empirically compare two types of trading strategies in a JV announcement event. We find that arbitrage trading between two partners' shares outperform the trading strategy of buy-hold two partners' shares when both rivalrous and non-rivalrous private benefits are large, while the trading strategy of buy-hold two partners' shares outperforms arbitrage trading when both private benefits are small. Our results can have implications for investors in terms of optimizing their trading strategies during the JV announcement period.

The paper is organized as follows: Section 2 reviews relevant literature and builds up testable hypotheses; Section 3 describes the data and sample; Section 4 presents the results; Section 5 concludes this paper.

2. Theoretical framework and hypothesis development

JVs provide firms with a means for combining imperfectly mobile and imperfectly imitable, but value creating, complementary resources possessed by partners (Chi, 1994; Hennart, 1988; Teece, 1986). Cooperative parents in a JV can share the JV's resource synergies and common benefits (Teece, 1986; Hennart, 1988; Kogut, 1991; Chi, 1994, 2000; Rothaermel, 2001; Kumar, 2005, 2011). Such valuation creation can be achieved without facing the asset valuation difficulties and inseparability in merger and acquisition (Balakrishnan and Koza, 1993), quickly before external opportunities are dissipated by rivals (Chi, 2000, 1994; Kogut, 1991; Kumar, 2005; Rothaermel, 2001), and without external transaction costs associated with market contracts such as in-licensing, out-licensing and cross-licensing of complementary knowledge bases (Chi, 1994; Hennart, 1988; Kogut, 1988; Lai & Chang, 2010; Williamson, 1991; Yiu & Makino, 2002).

However, because of shared governance structure and incomplete contracting, JVs can stimulate principal-principal type of agency problems (Claessens, Djankov, & Lang, 2000; Inkpen & Currall, 2004; Li, Zhou, & Zajac, 2009; Mjoen & Tallman, 1997; Pearce, 1997; Steensma & Lyles, 2000; Yan & Gray, 1994), leading to private benefits extraction and differential wealth gains between two partners (Kumar, 2010, 2011). These private benefits extraction hazards are particularly pronounced considering that JVs facilitate the transfer of relatively valuable knowledge bases compared to market contracts (Anand & Khanna, 2000; Hennart, 1988). These knowledge bases may include technical knowledge, upstream/downstream production knowledge, financial resources, and knowledge related to a target market such as customer characteristics, distribution channels, knowledge of culture and institutions, and so forth. The shared ownership and control of a JV expose these very knowledge bases to appropriation by the partner (Kumar, 2010, 2011).

Although there are various mechanisms in extracting private benefits out of a JV (Lavie, 2006), private benefits can be classified into two main types, according to the nature of the private benefits, i.e., whether private benefits acquired by a partner damage value to the other partner or not (Kumar, 2010, 2011). Type 1 non-rivalrous type of private benefits could arise, for example, due to spillovers or by observing and learning relatively diffused practices from the partner, such as the organisation of specific production processes, inventory management, market and country specific knowledge, and so forth (Ahuja, 2000; Inkpen & Dinur, 1998). The two partners' complementary knowledge bases provide opportunities for a partner to closely observe a firm's competencies and overcome barriers to imitation created due to causal ambiguity.

In contrast, type 2 rivalrous type of private benefits may arise when a partner appropriates relatively proprietary resources, including resources that are not directly deployed to the JV including poaching employees, stealing secrets, etc., or capturing a disproportionate share of common benefits by using its bargaining power to negotiate a higher

equity share *ex ante*. In such cases, the JVs may become subject to the prisoner's dilemma, learning races, and Trojan horses (Hamel, 1991; Parkhe, 1993; Reich & Mankin, 1986).

There are benefits-costs trade-offs associated with any private benefit extraction in a JV (Kumar, 2010). Private benefits arise due to the initial impact contract (Williamson, 1975), and may need *ex-post* costly monitoring and efforts devoted to learning and capturing the associated gains (Pearce, 1997). Thus the existence of private benefits does not automatically become realised gains, rather they necessitate significant managerial effort by the firm to extract so that the firm is able to capture the resources and realise associated benefits outside the JV (Kumar, 2010). On the other hand, the defensive attitudes on discovering a partner's intent to extract private benefits can lead to various contractual safeguards and more effort devoted to non-cooperative behaviour, leading to the higher costs in acquiring private benefits (Arino & de la Tore, 1998; Hamel, 1991; Kretschmer & Puranam, 2008; Larsson, Bengtsson, Henriksson, & Sparks, 1998; Parkhe, 1993; Postrel, 2002).

Previous literature does not specifically distinguish between two different types of private benefits, and particularly, does not distinguish the different benefit-cost tradeoffs in extracting two different types of private benefits out of a JV. In this research, we make the case that the nature of JV, i.e., whether a JV is characterised by a cooperative or non-cooperative environment can significantly affect the benefit-cost trade-offs associated with type 1 and type 2 private benefits. In a JV characterised by a cooperative environment, there are reduced defensive attitudes, thus enhanced scope to acquire type 1 private benefits without damaging the other's value, while in a JV characterised by a non-cooperative environment, there are enhanced defensive attitudes, thus enhanced costs to acquire type 2 private benefits. Given such different trade-offs associated with different types of private benefits extraction, different partners' characteristics can further affect benefit-cost tradeoffs in extracting different types of private benefits of a JV.

2.1. Economic importance difference of a JV held by partners and private benefits in a JV

Private benefits can possibly be extracted out of a JV when there are large monitoring asymmetries between two partners, resulting in one partner being taken advantage of by the other (Jensen & Meckling, 1976). A JV's economic difference between two partners affects one partner's incentives for monitoring efforts devoted to private benefits extraction and the other partner's incentives for various contractual safeguard-building efforts in order to prevent private benefits from being extracted (Diamond, 1991). Therefore, the economic importance difference of a JV held by partners ultimately can affect the benefit-cost tradeoffs in acquiring different type of private benefits out of a JV.

In terms of extracting type 1 non-rivalrous private benefits out of a JV, facing the costly observing and learning relatively diffused practices from the partner (Ahuja, 2000; Inkpen, 2000; Inkpen & Dinur, 1998), the JV's economic importance to a parent not only provides this parent firm with strong incentives to protect its own competitive resource from spillovering to its partner(s), for example by appointing relative function managers from its side (Li et al., 2009; Mjoen & Tallman, 1997), but also encourages this parent firm to devote more resources and efforts to observe and learn from the other partner. On the other hand, type 1 private benefits do not damage the value to the other partner, thus do not affect the dominated cooperative environment associated with a JV, which facilitates knowledge transferring, observing and learning from the other partner due to its less defensive attitude. Thus the asymmetric monitoring incentives due to JV's economic importance difference between two partners ultimately result that type 1 non-rivalrous private benefits can be extracted by a partner with a more economically important JV without damaging the value to the other partner to whom this JV is less economically important.

In terms of extracting type 2 rivalrous private benefits out of a JV, because it is the private benefits acquired by one partner by damaging the

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